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Supreme Court of the United States

OCTOBER TERM 1945—No. 1086

JULES E. PICCARD, on behalf of himself and for the benefit of and on behalf of the defendant, THE SPERRY CORPORATION, and all other stockholders of said defendant, THE SPERRY CORPORATION, who may be similarly situated,

Petitioner,

against

THE SPERRY CORPORATION, STANDARD CAPITAL COMPANY, J. CHEEVER COWDIN, GEORGE N. ARMSBY, THOMAS A. MORGAN, LINDSAY HOPKINS, EDWARD ALLEN PIERCE, individually and as directors and voting trustees, etc., ALEXANDER B. ROYCE and JOHN SANDERSON, individually and as directors, etc., THOMAS B. DOE, HERBERT H. THOMPSON, individually and as officers, etc., and CHARLES J. GLORE, J. RUSSELL FORGAN, WRIGHT DURYEA and others, individually and as partners trading under the firm name and style of FIELD, GLORE & COMPANY,

Respondents.

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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BRIEF FOR THE RESPONDENTS IN OPPOSITION

Opinions Below

The opinion of the District Court (Rifkind, D. J., R. 863-872) is reported in 48 F. Supp. 465. The opinion of the Circuit Court of Appeals (R. 897-898) is reported in 152 Fed. (2d) 465.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered January 10, 1946 (R. 899). The petition for a writ of certiorari was filed April 8, 1946. The jurisdiction of this Court is invoked under Section 240(a), as amended (28 U. S. C. A., Sec. 347a).

Questions Presented

The only questions presented by the petition for a writ of certiorari are:

Did the Circuit Court of Appeals, in unanimously affirming the decision of the District Court, decide (a) an important question of local law in conflict with applicable local decisions; or (b) a Federal question in conflict with applicable decisions of this Court.

Outline of the Case

This is not the conventional derivative suit. Here the defendant directors of the Sperry Corporation, long before stockholders interceded, vigorously asserted the claim involved against the defendant Cowdin, a fellow director; demanded the return of an alleged improper profit; and obtained substantial restitution without litigation or expense (R. 883-887).

The controversy among the Sperry directors arose out of the sale by the defendant Field, Glore & Company, under an option, of a substantial block of stock held by Sperry in the Curtiss-Wright Corporation. The defendant Cowdin, a Sperry director and a leading figure in the aviation industry (R. 164, 403, 405, 525), arranged the transaction with Field, Glore and, as president of Standard Capital Company, rendered substantial service in the sale of the stock (R. 882). For its efforts, Field, Glore had ceded to

Standard Capital a 50% interest in their profits (Plff.'s Ex. 4), on the express condition, however, that the participation be disclosed to and approved by the Sperry directors (Finding No. 35; R. 835). At the time of the transaction (September, 1935), Sperry had been attempting to dispose of its Curtiss stock for almost two years without appreciable success (R. 876) and no one believed that Field, Glore would succeed (R. 550, 658) or that there would be profits (R. 193, 195, 224, 526).

Cowdin disclosed to the Sperry directors that he expected a company in which he was interested would participate in Field, Glore's profits but did not inform them of the extent of its interest (R. 878). His position was that while a 50% participation had been suggested, no definitive agreement had actually been made on September 19, 1935, when the option was approved by the Sperry directors (R. 476).

A runaway market in aviation securities, commencing late in December, 1935 (R. 477; Ex. 80-A, p. 854; Ex. 80-B, p. 856; 882), resulted in profits beyond the expectations of any of the parties involved.

The Sperry directors insisted that Standard Capital was not entitled to its share of the profits (R. 883) because of Cowdin's failure fully to disclose the *amount* of its interest (R. 883). Cowdin violently disagreed (id., R. 477). In the settlement ultimately made, Standard Capital restored to the Sperry Corporation $101,407 (R. 887).

The following figures will exemplify how advantageous a settlement this was. The total profit amounted to $528,000. Under the option agreement, Field, Glore was first entitled to retain $1 per share profit on 82,582 shares of Class A, or $82,582, and 50¢ per share profit on 329,951 shares of common, or $165,976, making a total of $247,000 to be retained by Field, Glore. Deducting this amount from the total profit of $528,000, there remained $281,000 to be divided equally between Sperry and Field, Glore. It was on this basis that Field, Glore originally accounted to Sperry, sending to the Sperry Company their checks aggregating $140,864.08 (Plff.'s Ex. 13; R. 751).

Thus total profits were apportioned as follows:

Sperry	$140,864
Field, Glore	193,935
Standard Capital	193,935
	$528,734

As a result of the settlement, total profits were reapportioned as follows:

Sperry	$277,271
Field, Glore	158,935
Standard Capital	92,528
	$528,734

The option agreement had given Sperry an equal participation with Field, Glore in profits in excess of the minimum to be retained by Field, Glore for their services. As has been indicated, an unexpectedly favorable market developed for aviation securities. That favorable market produced additional profits of $281,000, of which Sperry was to have received one-half or approximately $140,000. The settlement, however, gave Sperry $277,000 or over 98% of these profits. Sperry got substantially the entire profit resulting from the favorable market. These figures portray better than can words that this was an arm's length negotiation in which the Sperry directors recovered for their company an amount which probably exceeded any net recovery that could have resulted from the most successful litigation.

The record, therefore, overwhelmingly established that the Sperry management rendered the corporation intelligent and farseeing service in consummating the settlement here attacked. Their wisdom in accepting restitution of more than half of the claimed improper profits, without loss of time or effort, and without litigation or expense, is an instance of the sound practical judgment of directors which has consistently received judicial approbation and has never been interfered with by courts.

Judge Rifkind, in his opinion, stated (R. 872):

> "It is not to the discredit of the defendant directors that they did not wait for the prod of minority stockholders but vigorously asserted the corporation's claim against their fellow director and obtained a settlement which, in view of the difficult issue of fact and the uncertainty attending all litigation, is fair."

The Questions of Law

Essentially, the questions which are sought to be presented to this Court are:

1. Whether, under applicable local decisions, despite findings that Field, Glore acted in good faith, Field, Glore was liable for participation in a breach of trust, or was in a fiduciary relationship to Sperry and breached a fiduciary obligation;

2. Whether the provision of the charter of the Sperry Corporation, authorizing an interested director to be counted for purposes of a quorum, was valid under Delaware law?

1. It will be established, as the District Judge found, that Field, Glore acted in good faith throughout; that there was no fiduciary relationship between Field, Glore and the Sperry Corporation; and that, in no event, is there any question of law warranting the consideration of this Court.

2. It will be demonstrated further that the provision in the charter of the Sperry Corporation, referred to by appellant, was perfectly valid, as the authorities fully established. There is no decision or statute in Delaware, prohibiting the stockholders of a corporation from consenting to participation by interested directors in corporate transactions. But, in any event, this provision was wholly unnecessary to the Court's decision. Whether or

not there was an interested quorum, a transaction which is fair and reasonable under all the circumstances will be sustained (*Pepper* v. *Litton*, 308 U. S. 295, and cases cited below).

ARGUMENT

I

In affirming the dismissal of the complaint as to Field, Glore, the Circuit Court of Appeals acted in accordance with applicable local decisions.

A

On findings based on undisputed evidence Field, Glore was properly held not to be liable for participation in a breach of trust.

In negotiations with Cowdin, Forgan of Field, Glore told him that the participation by Standard Capital in their profits must be disclosed to and be approved by the Sperry board of directors and by the New York Stock Exchange, and Cowdin agreed to the making of such disclosure (Finding No. 35; R. 880). Field, Glore instructed its counsel to collaborate on the preparation of the definitive agreement and to see to it that proper disclosure of the Standard Capital participation was made to the Sperry board (Finding No. 36; R. 880). Sperry's counsel told Field, Glore's counsel that a proper disclosure had been made by Cowdin and that a disinterested majority of the Sperry board had approved (Finding No. 38; R. 880). Field, Glore informed the Stock Exchange of the option agreement, of the arrangement with Standard Capital and that Field, Glore had been advised that the participation of Standard Capital had been communicated to the Sperry board (Finding No. 40; R. 881). Field, Glore believed that Sperry knew and had approved of Standard Capital's participation (Finding No. 41a; R. 881).

These findings compelled the conclusion reached by the Trial Court that Field, Glore "executed the September, 1935 agreement in good faith and in the reasonable belief that the facts concerning the participation of Standard Capital Company had been disclosed to and approved by the directors of the Sperry Corporation" (Conclusion No. 7; R. 888).

On these facts, Field, Glore clearly was not liable for participation in a breach of trust under applicable local decisions. The rule as to the liability of one dealing with a fiduciary is concisely stated in *Wechsler* v. *Bowman*, 285 N. Y. 284, 291:

> "Anyone who *knowingly* participates with a fiduciary in a breach of trust is liable for the full amount of the damage caused thereby to the cestui que trust." (Italics supplied.)

Petitioner disregards the essential qualification in this rule that the person to be charged must *knowingly* participate. That qualification is explicit in other statements of the rule.

> *Jackson* v. *Smith*, 254 U. S. 586, 589;
> *Irving Trust Company* v. *Deutsch*, 73 Fed. (2d) 121, 125.

The language adopted in the Restatement of the Law of Restitution, Section 138(2), expresses the same qualification in equivalent language. A duty of restitution is imposed only where a third person has "colluded with a fiduciary in committing a breach of duty".

Here the findings, fully supported by the testimony, establish that Field, Glore did not *knowingly* participate with Cowdin in any breach of trust. On the contrary, Field, Glore consented to a participation in its profits by Standard Capital on the express condition that the participation be disclosed to and approved by the Sperry Directors. The option agreement was made and the participation granted to Standard Capital only after assurance was received that the participation was fully disclosed to and approved by the Board of Directors of Sperry.

B

The Courts below properly found that Field, Glore was not in a fiduciary relationship to Sperry and did not breach any duty owed to that corporation.

Field, Glore was a partnership engaged in the investment banking business and a member of the New York Stock Exchange (Finding No. 11; R. 875). None of the Field, Glore partners was an officer, director or voting trustee of Sperry (Finding No. 12; R. 875). In January of 1935, Sperry placed with Field, Glore an order to sell 90,000 shares of Curtiss-Wright "A" stock at a minimum price of $10 a share. No stock was sold on this order since the market price never reached $10 a share before the order was cancelled by Sperry in September, 1935 (Finding No. 21; R. 876). The January sell order was cancelled on September 19, 1935 (R. 739), and the option agreement was not executed until September 25, 1935 (Finding No. 30; R. 878).

On these facts, the Trial Court concluded that there was no fiduciary relationship between Field, Glore and Sperry (Conclusion No. 6; R. 888). Petitioner's attack on this holding ignores both the law and the facts.

A stockbroker, of course, is an agent, and within the scope of his agency subject to all the normal duties of an agent to his principal. But agency does not create an unchangeable status. It does not prevent an agent from thereafter dealing with his principal or from profiting from a transaction which is outside the scope of his agency. As emphasized in *New York Trust Co.* v. *American Realty Co.*, 244 N. Y. 209, 216, the profits and advantages which an agent may not derive at the expense of his principal are *those* which are the "fruit of the agency" obtained "in the execution of the agency".

Field, Glore had properly performed under the January sell-order. It had kept its principal advised of its inability to perform the specific task imposed. No sales were made since the market never reached the specified price. "Once an

agent to sell has ended his agency through proper performance, he is, of course, free of all obligations" (concurring opinion of Frank, J., in *Shultz* v. *Manufacturers & Traders Trust Co.*, 128 Fed. (2d) 889, 899).

Petitioner's argument that Field, Glore was in a fiduciary relationship to Sperry ignores the fact that the January sell order was cancelled before the option agreement between Sperry and Field, Glore was entered into. The case of *Johnson* v. *Winslow*, 155 Misc. 170, affirmed 272 N. Y. 467, relied on by petitioner (Brief, p. 14) clearly recognized that where notice of a change of relation from that of broker and customer to that of dealer and customer is made clear, the former broker may properly purchase for himself the securities of his customer.

Sperry was aware of the fact that it was entering into a new and different arrangement with Field, Glore. Under the option agreement Field, Glore was plainly a purchaser of the stock (see *Lonsdale* v. *Speyer*, 174 Misc. 532, 546, 547, 550; aff'd 259 App. Div. 802; aff'd 284 N. Y. 756). The Courts below have therefore properly concluded that there was no fiduciary relationship between Field, Glore and Sperry.

Even if Field, Glore had been under a fiduciary duty as an agent to Sperry, on the undisputed facts as found, Field, Glore was not guilty of any breach of duty. Its own interest was fully disclosed and it was advised that a proper disclosure had been made by Cowdin and that a disinterested majority of the Sperry Board had approved (Finding No. 38; R. 880). The Restatement of the Law of Agency, Section 390, makes it clear that the duty of an agent to communicate to his principal all material facts in connection with a transaction is not unqualified. The duty exists "unless the principal has manifested that he knows such facts or that he does not care to know them". In comment "b" to this section the qualification is explicitly stated as follows:

> "These statements are subject to the limitation that if the principal manifests that he knows all material facts

> or is willing to deal without knowing them, the agent is not liable if he fails to reveal them."

See also Restatement of the Law of Restitution, Section 191, subdivision (2).

Here the Courts below have found that Field, Glore believed that Sperry knew and had approved of Standard Capital's participation (Finding No. 41a; R. 881) and that Field, Glore executed the option agreement "in good faith and in the reasonable belief that the facts concerning the participation of Standard Capital Company had been disclosed to and approved by the Directors of the Sperry Corporation" (Conclusion No. 7; R. 888). On these facts the Court could not have found that Field, Glore breached any duty owed by it to Sperry even if the existence of a fiduciary relationship be assumed. The complaint was therefore properly dismissed.

II

The settlement was made in good faith and was valid. Therefore, the releases delivered by Sperry and Sperry Securities Corporation to Standard Capital Company and Cowdin are valid and binding.

The Sperry charter (Par. 10) provided that a director shall not be deemed interested, solely by reason of stock ownership in a company contracting with Sperry. Petitioner contends that this provision was invalid. There is no merit to that contention. Nor need that question be determined here.

The Court below held, not only that Paragraph 10 of the Charter was valid, but that the settlement was fair and made in good faith (Finding No. 73; R. 887); and was, in any event, approved by a majority of disinterested directors, constituting a quorum (R. 884, 886, 871). Based on this and other findings, the Court below concluded that the releases delivered to Standard Capital Company and Cow-

din are valid and binding (Conclusion No. 8; R. 888). In view of these findings, the validity of the charter provision involved need not be considered.

(1) It is well established that the conflicting interest of one or more corporate directors is not alone sufficient to render their action void. It requires only that the Court scrutinize their action with care and determine whether it was fair under all the circumstances.

Twin Lick Oil Co. v. *Marbury*, 91 U. S. 587, 589;
Pepper v. *Litton*, 308 U. S. 295;
Geddes v. *Anaconda Copper Mining Co.*, 254 U. S. 590, 599;
Corsicana National Bank v. *Johnson*, 251 U. S. 68, 90;
Cowell v. *McMillen*, 177 Fed. 25, 39 (C. C. A. 9th).

In the absence of proof of unfair dealing, the courts have uniformly approved corporate transactions, even where some or all of the individual directors represented seriously conflicting interests.

Crawford v. *Mexican Petroleum Co. of Delaware*, 130 Fed. (2d) 359 (C. C. A. 2d 1942);
Blaustein v. *Pan American Petroleum Co.*, 293 N. Y. 281, 298;
Everett v. *Phillips*, 288 N. Y. 227, 236;
Chelrob Inc. v. *Barrett*, 293 N. Y. 442, 460.

The Delaware courts are in accord with the rule that the interest of a director in a corporate transaction does not of itself render the transaction void. Bad faith or overreaching must be established.

Potter v. *Sanitary Co.*, 22 Del. Ch. 110; 194 Atl. 87, 91;
Eshelman v. *Keenan* (Del. Ch.) 2 Atl. (ad) 904, 908.

Consequently, even if Paragraph 10 of the Sperry Charter were invalid, the finding that the settlement was fair and made in good faith is conclusive upon the issues of this case.

(2) In any event, the settlement was in fact approved by a majority of disinterested directors constituting a valid quorum, without regard to the Charter provision. During the relevant period, there were eight Sperry directors: Morgan, Sanderson, Pierce, Royce, Doe, Cowdin, Armsby and Hopkins (R. 884; 886). Under the By-Laws a quorum consisted of a majority of the directors then in office, not less than two (R. 689). When the settlement was ratified, at the Sperry board meeting on July 28, 1936, all eight directors were present. The settlement was approved by all except Cowdin and Armsby, who did not vote. Whatever law were applicable, five directors would constitute a quorum and if they took unanimous action would, of necessity, constitute a majority at any meeting. Unquestionably, Doe, Hopkins, Pierce, Royce and Sanderson were disinterested. Ratification, therefore, was valid without reference to the Charter.

But Morgan, as well as Sanderson, was disinterested. At the time of the meetings, Morgan and *Mrs.* Sanderson each owned 50 shares of common and 50 shares of preferred stock of Standard Capital Company, for which each paid $5,050. Standard Capital Company had outstanding at the time 10,555 shares of common and 4,750 shares of preferred. Therefore, Morgan and Mrs. Sanderson each owned ½ of 1% of the common and 1% of the preferred stock of Standard Capital Company.

This inconsequential stock interest of Morgan does not constitute a disqualification under the authorities. Sanderson certainly was not disqualified by his wife's stock interest acquired with her own independent means (R. 276, 360, 871).

As to Morgan, it is well settled that a nominal stock interest is not disqualifying (*Sage* v. *Culver*, 147 N. Y. 241, 247; *Michoud* v. *Girod*, 4 How. (U. S.) 503, 554; *Restatement of the Law of Restitution*, Sec. 192; *Restatement of the Law of Trusts*, Sec. 170, pp. 432-3; 29 Columbia L. Rev. 338, 342).

As to Sanderson, the District Judge ruled that Sanderson's vote cannot be disregarded because, as the District Judge found, "The evidence does not suggest that Sanderson was the beneficial owner of his wife's stock. No one testified that Sanderson held the stock in his wife's name or that it was bought with Sanderson's funds. * * * The evidence does not support the contention that he was an interested director" (R. 871).

In sum, the Court below held that in settling the controversy with Standard Capital Company and Cowdin, the action of the directors was attended by "good faith, sound business judgment and prudent solicitude for the welfare of the corporation" (R. 865). The Courts have repeatedly held that a settlement thus made is binding and may not be set aside because a minority stockholder disagrees with the judgment of the directors.

Corbus v. *Gold Mining Co.*, 187 U. S. 455, 463;
Mendelson Bros. v. *Sachs*, 253 App. Div. 270, aff'd 279 N. Y. 604;
Continental Insurance Co. v. *N. Y. & H. R. R. Co.*, 187 N. Y. 225;
Kirchner v. *N. H. S. M. Co.*, 135 N. Y. 182, 188;
Holland v. *Presley*, 225 App. Div. 667, 669, aff'd 280 N. Y. 835.

(3) Moreover, paragraph 10 of the Charter is valid. Nothing contained in the Charter clause in question is in conflict with any statutory prohibition or with any public policy of the State of Delaware. Stockholders or the beneficiaries of any trust may consent "that the trustee shall act under conditions of divided loyalty."

Chandler v. *Bellanca Aircraft Corp.* (Del. Ch.), 162 Atl. 63, 67;
Matter of Balfe, 245 A. D. 22, 24 (2nd Dept.);
Butterfield v. *Cowing,* 120 N. Y. 486;
Everett v. *Phillips,* 288 N. Y. 227;
Voigt v. *Remick,* 260 Mich. 198, 244 N. W. 446;
Helfman v. *American Light & Traction Co.,* 121 N. J. Eq. 1, 187 Atl. 540;
Spiegel v. *Beacon Participations,* 297 Mass. 398, 417, 8 N. E. (2d) 895;
Restatement of the Law of Trusts, Sec. 216;
Restatement of the Law of Restitution, Sec. 191.

The Delaware cases, relied on by appellant for a contrary view, are not in point—no provision of the certificate of incorporation was involved.

This charter clause affords no greater latitude to a director than does a clause authorizing directors to act in matters where they have conflicting interests; and the cases are legion in which the validity of charter clauses authorizing "interested" directors to act have been sustained.

Everett v. *Phillips,* 288 N. Y. 227;
Chelrob Inc. v. *Barrett,* 293 N. Y. 442;
Spiegel v. *Beacon Participations, Inc.,* 297 Mass. 398, 8 N. E. (2d) 895;
Helfman v. *American Light & Traction Co.* (N. J. Ch.), 187 Atl. 540;
Voigt v. *Remick,* 260 Mich. 199, 244 N. W. 466.

Therefore, even if the stock interest of Morgan and Mrs. Sanderson in Standard Capital Company could under any circumstances be said to constitute a disqualification, the charter clause in question precludes that inference.

In any event, there is nothing for this Court to review.

CONCLUSION

The decision below is in accord with applicable local decisions and it is not in conflict with applicable decisions of this Court. It is, therefore, respectfully submitted that the petition for a writ of certiorari should be denied.

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